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## HOW TO AVOID GOVERNMENT OWNERSHIP OF THE RAILROADS

To avoid government ownership and yet provide adequate railroad facilities for all the people at moderate cost is a problem in which everyone ought to be interested.

Prior to the enactment of the Interstate Commerce act<sup>1</sup> in the year 1887, railroads in the United States were built and operated with but little public supervision. Gross public abuses had become so common that an antagonistic public regulation was inevitable; and the first step in that direction was the creation of the Interstate Commerce Commission with certain *restraining* powers over railroad operations and charges. The act contained no provision for helpful co-operation of the Commission with the railroads; the spirit of the times did not require it. The chief function of the Commission was, and still is, to prevent abuses; it was not empowered to *improve* conditions that were non-abusive. The railroads met this agency of corrective legislation with hostility and contempt, evading its regulatory efforts with the same short-sightedness that had fostered the very abuses which made such regulation imperative. The result was more and more of hostile regulatory legislation, state and national, until today it is universally conceded that the railroads are overregulated. There is now a tendency among the railroads to meet the public more than half-way; but the public wrath has not subsided. Public sentiment still demands punishment of the railroads, and exerts an influence upon the machinery of justice which makes it impossible for the railroads to obtain a "square deal." Railroad investment is no longer attractive to private capital, and railroad development and expansion have almost come to a standstill.

Undisputed evidence produced at the hearings before the Newlands investigating committee late in the year 1916 disclosed the fact that in the year last preceding there had been fewer miles of new railroad lines or extensions constructed in the United States

<sup>1</sup> Act of February 4, 1887, ch. 104, 24 Stat. L. 379.

than in any year since the Civil War, with one exception. Inability to obtain capital was the cause assigned for such lack of progress, and experts testified that there was no hope of improvement in investment conditions and predicted government ownership as the logical result. Since the tendency of all modern rate regulation is to prohibit more than a fair interest return upon the value of the property used in the public service, there is no inducement to further investment of private capital in new lines or extensions. The once attractive speculative element is now removed entirely, but there is no corresponding elimination of risks and hazards. If the new venture is a failure, the investor loses his capital; if it is a success, he gets at most only a bare interest return, and the public takes the remaining fruits of the investment in reduced rates. Under such adverse conditions, private capital is being invested in nearly every other enterprise in preference to railroad extensions. This condition cannot permanently exist. Must there be complete government ownership, or may there be merely co-operative aid and assistance, financial as well as supervisory, but not ultimately proprietary?

The evils of complete government ownership are well known and need not be here discussed. It will suffice to say that the creation of vast political power and the deadening of individual initiative which would result from government ownership are quite enough to condemn it, unless it is shown to be the least of necessary evils which cannot be avoided. Canada has government railways and railroads privately owned, and has found the latter the more satisfactory.

The continued operation of railroads *now existing*, with proper improvements, repairs, and replacements, can be accomplished by maintaining rates at a level high enough to provide the necessary revenues for all these needs; and the control of Congress and the Commission over the railroads is already broad enough to compel the application of such revenues to such purposes, after first paying a fair return upon the value of all privately owned railroad property. Rates at least sufficient for such purposes must be maintained, whether the railroads are privately owned or owned by the government.

But there is no method by which the construction of *new* lines, *extensions*, or *connections* can be compelled. It is true that the Supreme Court of the United States has recognized the right of railroad commissions to compel connections where the public necessity was very great and the expense incurred was comparatively small.<sup>1</sup> But the doctrine of such decisions has been very carefully restricted, and its application has been specifically denied in cases where the extensions involved were economically desirable.<sup>2</sup> It is safe to say that the Supreme Court of the United States will never sanction any attempt by Congress or the Commission to compel new investment of private capital in relatively substantial amounts. For such compulsion would be contrary to the fundamental and constitutional right of the individual to invest his own money where he wills. Neither can Congress or the Commission make the net return upon existing railroad property sufficient, by high rates, to yield a surplus, and then compel the investment of that surplus in the construction of new lines or extensions. For such surplus would be the private property of the railroad stockholders, and they could no more be forced to invest that money in a *new* enterprise than to make like investment of any other part of their private capital. The power of the government to compel proper maintenance of *existing* railroads is based upon the voluntary undertaking of the railroad builders to perform such duties in return for the grant of special privileges (including the right of eminent domain) to their corporations; but their obligations are confined within the limits of such voluntary undertaking. As originally they could not have been forced to engage in such enterprise, so now they cannot be compelled involuntarily to extend it. The problem, then, is to find a cure for the present stagnation in railroad expansion.

The remedy lies in temporary government investment in extensions and improvements until such time as the natural

<sup>1</sup> *Wisconsin, Minnesota & Pacific Railroad Co. v. Jacobson*, 179 U.S. 287; 45 L. Ed. 194.

<sup>2</sup> *Missouri Pacific Railway Co. v. Nebraska*, 164 U.S. 403; 41 L. Ed. 489; *Missouri Pacific Railway Co. v. Farmers' Elevator Co.*, 217 U.S. 196; 54 L. Ed. 727; *Washington v. Fairchild*, 224 U.S. 510; 56 L. Ed. 863; *Great Northern Railway Co. v. Minnesota*, 238 U.S. 340.

development of the country produces business sufficient to yield a fair net return upon the value of the property used in such public service. This may be accomplished under direction of the Commission, properly constituted and endowed with enlarged powers—of which more will be said later. Whenever it appears that the public interests would be promoted by the extension of any interstate railway system, or some part thereof, and it further appears that such extension necessitates an unprofitable initial expenditure, the government itself should invest in the enterprise such sum of money as may be necessary to render all private investment therein reasonably remunerative—a return upon the government capital being deferred until all private investors shall have been first adequately rewarded. The government should become the owner of capital stock of the railway company in which government capital is invested, in such proportion as the government investment bears to the fair value of the whole property of the railway company;<sup>1</sup> and the government should from the beginning possess all the rights of private stockholders except that of profit-sharing. The private investor should be, in effect, a holder of preferred stock entitled to adequate dividends from the first profits of the enterprise; and the amount of such preferred stock issued should be limited to, and correspond with, the railway company's ability to pay proper dividends thereon. Rates should be maintained at a level consistent with community development, but should *not be lowered* with the increase of business which would naturally follow such railway extension and improvement; and whenever the increased volume of business would produce revenue sufficient to pay a full return upon all the capital invested, government as well as private, the government stock should be sold to private investors who should then be entitled to all the rights of other

<sup>1</sup> The fact that outstanding stock of railway companies does not always, or even usually, represent the true value of their property would not interfere with government investment as above suggested. If the true value of the railroad property were only one-half the face value of outstanding stock, then the government should receive two dollars in stock for each dollar it invested. And as the government has undertaken, by physical valuation and other means, to determine the true value of all railway property and will finally compel the railway companies to accept its findings, the issuance of the proper proportion of stock for government investments would be merely a matter of simple computation.

similar stockholders. The private stockholders at the time of sale should be given a first chance to purchase the government stock at par value, as that would enable them to bar out persons whom they deemed undesirable as stockholders.

The provision for payment of a fair return upon private capital should not be in the nature of a guaranteed and fixed dividend, however, as that would destroy the incentive to efficiency quite as effectually as government ownership itself. On the contrary, the return to be paid upon private capital should be variable in amount and should correspond with the degree of efficiency and economy attained in the management and operation of the enterprise. It is possible to determine in many ways the extent of efficiency accomplished in the operation of any railroad system. The ratio of operating expense to gross income may be compared with that of other railways operating under substantially similar circumstances and conditions, and a fairly accurate general standard of efficiency may be based upon such comparisons. Other statistical comparisons may be used as a further aid in determining a proper standard. The dividends for the private investor should be increased in proportion to the decrease in expenses of maintenance and operation which his railway company achieves; and possible maximum dividends should be sufficiently large to make skilful management and operation highly desirable. On the other hand, failure of his railway company to measure up to a reasonable standard of economy and efficiency in maintenance and operation should be penalized by correspondingly decreased dividends to the private investor. To illustrate: About 70 per cent of the gross income (under present rates) of some great railway systems is now being consumed in the payment of operating expenses. If this percentage should be found a fair standard for a particular railroad in which the government had become a stockholder under the plan here suggested, then for the attainment of that standard a dividend of 7 per cent per annum might be allowed to private stockholders, while a decrease in operating expenses to 70 per cent of gross income should be rewarded with a 10 per cent dividend; and an increase in operating expenses to 75 per cent of gross income should be penalized by a decrease in dividends to 5 per cent per annum.

The Commission could be depended upon to see that decreased operating expenses did not result in poor service to the public. It is well known that the percentage of gross income consumed in operating expenses on any railway system decreases as the volume of business or traffic increases. The railroads would, therefore, have a direct pecuniary interest in increasing business in order to get the increased dividends allowed for low operating expenses. The natural increase in the volume of business which would result from community development where extensions had been constructed by the aid of government money would eventually create a surplus, after payment of dividends upon all private capital invested; and whenever the constant production of such surplus should become sufficient to pay dividends upon the government stock, then such stock ought to be sold to private persons, and the proceeds reinvested in other extensions elsewhere. A sort of revolving fund would thus be created, which in course of time would become large enough to meet all requirements of the government in railroad extension work without further appropriations by Congress. To keep faith with the purchasers of government stock, the Commission should not thereafter reduce the rates until the net return had become more than sufficient to pay the maximum dividends allowed to private stockholders before the sale of government stock. The variable dividends suggested as a reward for efficiency ought to be allowed by the Commission on all railway systems, whether government capital be invested therein or not; for where is the incentive to efficiency under the present practice of reducing the rates whenever the profits become more than sufficient to pay a barely non-confiscatory return? At present, efficiency is penalized, not rewarded.

It is not thought that the plan here presented, if adopted, would be entirely free from difficulties. On the contrary, it would require time and experience to perfect and adjust a workable system for such government aid. But the difficulties would not be insurmountable, nor even comparable with the perplexing problems that would arise under complete government ownership.

Under the scheme herein outlined, the amount of government aid extended in a particular case would be neither too much nor

too little, but exactly the amount necessary. The original government capital so invested would be the proceeds of indirect taxation equally distributed over all the people, and would surely be as beneficially expended as when collected from the public by the railroads through increased rates. The capital required for future railroad extension must come from one or the other of these sources. The amount of government capital required for such purposes would be relatively small—especially when compared to the amount necessary for complete government ownership. The control of such capital would be direct and effective, while, as already shown, the control of surplus capital collected by the railroads themselves through increased rates would be wholly lacking or very incomplete. The government as a stockholder in the railway companies would have a proprietary as well as a sovereign or governmental interest in the affairs of the railroads, and it could keep in closer touch with the business of the railroads than under present conditions. With the government itself financially interested, railroad rate regulation would be more sane and less hostile. All the evils of complete government ownership would be avoided, and all the advantages of private management and individual enterprise would be retained. If an occasional investment of government capital should be made and totally lost, that would be less harmful than if the same ill-starred enterprise had been privately financed, since the tendency of the times is to allow private railroad investors a barely adequate return upon *successful* ventures only, without any allowance for losses elsewhere. Appropriations by Congress for such government investment should never be made unless requested by the Commission; and as the Commission would not be amenable to local influences, the “pork barrel” evil would be eliminated.

This plan for temporary government aid is neither radical nor very novel. The United States has been in the business of financially aiding railroad-builders for nearly a century, but the methods of extending such aid have been wasteful and ill advised. Usually it has been in the form of land donations unconditionally granted. The Union Pacific, the Northern Pacific, and the Southern Pacific systems are conspicuous examples of wastefully aided railroads.



The courts are even now burdened with litigation wherein the United States seeks to recover oil and mineral lands found to be more valuable than was supposed at the time such lands were donated. The Northern Pacific Railroad Company received from the United States every alternate section of public land, not mineral, to the amount of twenty alternate sections per mile on each side of its railroad from Lake Superior to Puget Sound, a distance of nineteen hundred miles.<sup>1</sup> This donation included millions of acres of the finest agricultural land in the world. Yet at the time of construction of that railroad—less than fifty years ago—the Northern Pacific Railroad Company probably would have preferred a cash investment of one hundred and fifty million dollars in non-dividend-paying stock of the company. Such stock since would have become remunerative and could have been sold by the government at par, while the lands donated undoubtedly could have been sold for more than the full amount of accrued interest on such government investment. Thus to extend aid from the government by donation of land or property of speculative and uncertain value was not businesslike, since it must eventually prove to be either wasteful or insufficient. In the United States Senate in 1858 Senator Greene of Missouri said: “I believe the Pacific Railroad will increase the productive power and wealth of the country millions and tens of millions, although I believe every dollar invested in making such a road will be lost to the stockholders, whether built by the Federal Government or by private enterprise.” His views were probably shared by most of his colleagues. But less than thirty years later Congress felt impelled to pass the Interstate Commerce act to prevent that same railroad company (with others) from becoming unduly enriched through the large volume of public business it was transacting.

The Canadian government, prior to the construction of the Canadian Pacific Railway, offered to aid the prospective builders of that line by donating twenty thousand acres of land and ten thousand dollars cash per mile, and guaranteeing dividends of 4 per cent per annum for twenty-five years upon such amount of

<sup>1</sup> Act of July 2, 1864, 13 Stat. L. 365.

private capital as might be necessary to procure the construction of the road. The offer was not accepted. The Canadian government then itself constructed more than six hundred miles of railroad through the mountains at a cost of thirty-one million dollars, which road was donated to the Canadian Pacific Railway Company together with twenty-five million dollars in cash and twenty-five million acres of land; and thereafter in 1884, the Canadian government made a temporary loan of thirty million dollars to the railway company—which was repaid with interest before maturity.<sup>1</sup> If the Canadian government had taken stock in the railway company for the donations then made, it would long since have been able to commence the collection of dividends upon such stock, after first allowing the railway company to pay all private investors ample dividends upon their capital. Further illustrations of misdirected government aid would be superfluous.

To insure the success of government investment in aid of railroad expansion, several changes in the existing order of things are desirable.

If the railway companies should object to the issuance of stock to the government in proportion to the capital it invested, federal incorporation of interstate railway companies might become a preliminary necessity. The law providing for such incorporation should also provide for coinvestment by the government. It is believed, however, that no objection to government investment would be made by the railway companies, although the status of the government as a minority stockholder would increase its control over such railways materially.

The personnel of the Commission should be changed by the addition of railroad representation thereon and temporary labor representation in the settlement of labor disputes. It is a popular fallacy to assume that the Commission, as now constituted, is a judicial body.<sup>2</sup> True, the Interstate Commerce act provides that the Commission may hear and determine certain controversies in

<sup>1</sup> Facts are stated in *Canadian Pacific Railway Co. v. The James Bay Railway Co.*, 36 Canada Supreme Court Reports 42, at p. 73.

<sup>2</sup> "The commission has no judicial power and is not a court." *Interstate Commerce Commission v. Louisville, etc., R. Co.*, 73 Fed. 409; *Interstate Commerce Commission v. Cincinnati, etc., R. Co.*, 64 Fed. 981; *Kentucky Bridge Co. v. Louisville, etc., R. Co.*, 37 Fed. 567.

its *administrative* capacity, but always subject to review by the courts. The primary purpose for which the Commission was originally created, however, is shown by the following provisions of the act:<sup>1</sup>

That the Commission hereby created shall have authority to inquire into the management of the business of all common carriers subject to the provisions of this act, and shall keep itself informed as to the manner and method in which the same is conducted, and shall have the right to obtain from such common carriers full and complete information necessary to enable the Commission to perform the duties and carry out the objects for which it was created; *and the Commission is hereby authorized and required to execute and enforce the provisions of this Act.*

An organization charged with such duties cannot be truly judicial. The Commission cannot act as public prosecutor and judge at one and the same time. The duties are inconsistent, and proper performance of both is impossible. No man can serve two masters. Justice McReynolds, following an age-old custom, has declined to sit with the Supreme Court of the United States in the decision of cases in which he had been public prosecutor as Attorney-General in the courts below.<sup>2</sup> The Commission has performed quasi-judicial functions as incidental to its administrative duties only. But as a public prosecutor of wonderful efficiency, the Commission has ears singularly sensitive to the complaints of the general public, but no eyes to see from the standpoint of the investor. In the beginning such attitude was proper, but the time is now ripe for a change. The railroads have been prosecuted and regulated to the verge of ruin; helpful co-operation is now the first necessity. A commission of nine men, four appointed by the government and four appointed by the railroads with a disinterested chairman chosen by Congress, would make a good general board of directors to whom might safely be intrusted the whole public interests, including the welfare of private investors. The powers and duties of the Commission, so constituted, should correspond in a broad, general way with the powers and duties of the board of directors of a great corporation; and appeal to the courts by parties in interest dissatisfied with the acts of such Commission should be allowed only in cases analogous to those where there is

<sup>1</sup> Section 12 of the Act to Regulate Commerce, 3 Fed. St. Ann. 838.

<sup>2</sup> *O'Keefe v. United States*, 240 U.S. 294; 60 L. Ed. 652.

a right of access to the courts for relief from the acts of a board of directors of a private corporation.

The Commission should be expressly authorized by Congress to prescribe minimum as well as maximum rates, and to prevent and remove all discriminations and inconsistencies resulting from intrastate rates, so that the doctrine of the Shreveport case<sup>1</sup> would no longer be a matter of doubt. Only by the exercise of such powers can the revenues of interstate railroads, under any prescribed system of rates, be made constant and certain.

Following the Pennsylvania Utilities act,<sup>2</sup> the Commission should be authorized to restrain and prevent the construction of any new railroad or branch line in competition with any government-aided existing road, unless in the opinion of the Commission the public interests required both roads. Competition with the United States Post-Office has long been a crime,<sup>3</sup> and the same principle should be applied in the case of government-aided railroads.

Compulsory arbitration of labor disputes should be provided for the same reason that competition is prohibited. Opposition to such law by organized labor would probably be withdrawn if it was provided that labor disputes must be submitted to the Commission temporarily augmented by four labor representatives for the occasion, and, with this enlargement, empowered to render a decision binding upon all parties in interest.

Other details would doubtless require legislative attention in course of time, but it is believed that no serious obstacles to government investment in aid of railroad expansion would be encountered if the present system of aimless and hostile regulation were discontinued, and a policy of businesslike co-operation and sane supervision were substituted. Some method of providing capital for future development of the railroads must be devised, and it is thought that the scheme here outlined is preferable to government ownership on the one hand or continued stagnation on the other.

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<sup>1</sup> *Houston, etc., Ry. Co. v. United States*, 234 U.S. 342; 58 L. Ed. 1341.

<sup>2</sup> Act of July 26, 1913, Session Laws of Pennsylvania, 1913, p. 1374.

<sup>3</sup> Act of June 8, 1872, ch. 335, 17 Stat. L. 311; 5 Fed. St. Ann. 904.